"Modernizing Multilateralism and Markets"

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I. Looking Back –To See Ahead

How will people in 2018 look back on this year?

It depends on what we do.

September was a hard month in a precarious year. A meltdown in financial, credit, and housing markets. The continuing stress of high food and fuel prices. Anxieties about the global economy.

Over the past year, most developing economies grew robustly despite the turmoil. In fact, major developing countries powered an alternative engine of growth. In 2007, they averaged a record 7.9 percent in GDP growth and in 2008 perhaps a still impressive 6.6 percent.

But this is not shared by all. Soaring food and fuel prices are plunging the most vulnerable into a danger zone.

People are hurting. Families are worried about what coming days will bring.

The events of September could be a tipping point for many developing countries. A drop in exports, as well as capital inflow, will trigger a falloff in investments. Deceleration of growth and deteriorating financing conditions, combined with monetary tightening, will trigger business failures and possibly banking emergencies. Some countries will slip toward balance of payments crises. As is always the case, the most poor are the most defenseless.

While American eyes are on the intersection of Wall and Main Streets, there is much more to the story. The response to these crises will have to be larger and global.

Voices around the world are blaming free markets. Others are asking about the failures of government institutions. Many will point fingers at the failings of the United States, as the architect of today's global economy.

We cannot turn back the clock on globalization. Nor can we let the crisis of today blind us to the opportunity of tomorrow.

We must learn the lessons from the past, as we build for the future. We must Modernize Multilateralism and Markets for a changing World Economy.

Ours must be globalization where both the opportunities and the responsibilities are more widely shared. Without that, we may design a new architecture but it will be a house of cards.

Multilateralism, at its best, is a means for solving problems among countries, with the group at the table willing and able to take constructive action together.

I am a mechanic in multilateralism. For over 20 years, I have been involved in trying to make the international system work. Next week, at the Bank-IMF Annual Meetings, I will turn to the implications of the last twelve months for the World Bank Group. But today, with a crisis in progress and an election within weeks, I will sketch a larger drawing.

II. Transformation in the Global Political Economy

To understand today's crisis, we need to consider what has happened over at least the last 20 years.

Today's globalization and markets reflect huge changes in information and communications technology, financial and trade flows, mobility of labor, worldwide interconnectivity – "the death of distance," and vast new competitive forces.

But even those transformations do not capture the biggest change: Over the past 25 years, the world market economy has grown from about 1 billion to 4 or 5 billion people. The world's labor force engaged in export markets has grown to over 800 million. These are amazing increases in a relatively short period.

The competition of globalization, the huge expansion of the global labor force, and relatively low commodity prices combined to create something else: a Golden Era for the central bankers. The price dampening effects of these shifts made central bankers look like technocratic wizards – and we liked their magic.

Loose monetary policies and abundant liquidity led investors to "chase yield" – and one another. Investors lent and leveraged against seemingly ever-rising asset values, without attention to credit risk, earning power, and cash flows. Investors did not plan to hold the assets long enough to wait for earnings. Even when they did, the investor share was "guaranteed" by assurances "backed by" those same high asset prices.

With the burst of the internet bubble and Japan's long real estate and banking crisis, the liquidity deluge spilled over to developing countries, especially those whose currencies were pegged to the dollar. Commodity prices fell with the collapse of the Soviet Union, leading to under investment, especially in oil and metals, and then rose dramatically as developing economies hungered for inputs. Fuel and food became increasingly linked, both because the share of energy used in food production and transport increased, and consumers of food and energy have become competitors: A food for oil crisis in the making. And this year we saw it erupt.

The higher prices could push some 100 million people in developing countries back into poverty. We risk a second round of inflation, balance of payments crises, and tight budgets.

The sources of international capital pools have been shifting, too. The commodities boom, especially for energy, led to huge returns, ending up in sovereign wealth funds. Burnt by the trauma of 1997-98, some developing countries resolved never to risk that anguish again and managed exchange rates to create immense reserves. These savings seeded other sovereign funds.

Changes in labor forces, financial liquidity, commodity markets, and sovereign funds reflect an even more significant transformation: New economic powers are on the rise.

The engagement of rising powers with the global economy has made them "stakeholders" in the global system. China is now the world's third largest trading entity. As the middle class grows in Asia, these savers will become important investors in corporate equities in developed countries, further strengthening global links.

These rising powers want to be heard. They want to know what will be their role in making the new rules for the global economy. Having demonstrated their competitive success, these rising powers are suspicious that the more established stakeholders will hold them back, whether through old rules of trade and finance, or new rules for climate change and the environment.

The developed economy "stakeholders," in turn, both benefit from – and are threatened by – the changes. Rising developing economies offer multiple poles of growth that assist their recoveries and offer new possibilities, but they also serve as fodder for scaremongers. Indeed, with growth rates averaging about 6.6 percent between 1997 and 2007, some 25 countries in sub-Saharan Africa, with almost two-thirds of the region's population, offer a vision of yet another pole of growth that might be developed over the coming decades. This could be a great achievement, not only for overcoming poverty and for development, but also freeing untapped talents and energies.

But it will be an achievement left unrealized unless we have the vision and the courage to stand up to the challenges of economic isolationism at home, and to offer the leadership to help make it happen. The financial and economic pains and fears will reinforce a tendency to pull back. Some feel that the rules of the game – dealing with bailouts, exchange rates, trade, immigration, and foreign aid – leave them out, even if people with higher incomes seem to be able to take advantage of the changes. Many worry that the old "safety nets" to help people adjust to change are woefully out of date. This agenda – not just the aftermath of financial rescues – must be seized by new leaders.

III. Storm Clouds Over Multilateralism and Markets

The events of this year are a wake up call.

There are storm clouds over multilateralism and markets.

As food prices soared, agricultural markets started to break down under political pressures. Some 40 countries imposed bans or restrictions on exports of food. Others imposed price controls, broke contracts, and halted trading. The UN strained mightily to get countries to double their contributions to food assistance for those most in need. Poor nations struggled to get seeds and fertilizers to farmers. They tried to patch together "safety nets" for the most vulnerable. Poverty, hunger, and malnutrition increased.

As the global system for agriculture ran aground, the World Trade Organization drifted into dangerous waters. The Doha Round has hit the rocks.

The Climate Change negotiations organized under the UN Framework Convention on Climate Change will be made more difficult by the WTO's discord, which will exacerbate the tensions between developed and developing economies. Under the best of circumstances, this negotiation will be an uphill struggle.

Furthermore, the "cap-and-trade" climate change bill that failed in the U.S. Senate this year points to the next challenge for multilateralism and markets. To avoid putting industries subject to carbon caps at a competitive disadvantage, the bill invoked trade protections against exporters that did not face carbon limits.

While needs are growing, the international aid system is not keeping pace.

Donors bring ideas, energy, and resources, but they also can overwhelm national ownership by developing countries, harming the effectiveness of aid. In 2006, there were more than 70,000 aid transactions with an average project size of only $1.7 million. Last year, the average developing country hosted 260 donor visits. Vietnam had 752.

National governments are drawn increasingly to provide aid with their flag, not through multilateralism that encourages coherence and building local ownership. Even so, the G-7 as a whole is far behind its Gleneagles' commitments to boost development assistance.

Private financial markets and businesses will continue to be the strongest drivers of global growth and development. But the developed world's financial systems, especially in the United States, have revealed glaring weaknesses after suffering titanic losses.

The international architecture designed to deal with such circumstances is creaking.

Perhaps the most striking change since my experience in the U.S. Treasury in the 1980s is the loss of fortunes of the G-7. This group once played a valuable role coordinating policy, with agreements such as the Plaza and the Louvre Accords. But the Economic Summits long ago placed a priority on ceremony over policy. I still harbor hope that the meetings of Finance Ministers will offer a multilateral navigator in dealing with global financial and economic problems. But the forum falls far short of the need.

IV. A New Multilateral Network for a New Global Economy

Even as the United States and the world dig out of the present hole, we need to look further ahead: We will need a New Multilateral Network for a New Global Economy.

The Bretton Woods generation left two legacies: first, international institutions and regimes – in various states of service and repair. Second, and more important, that generation left an intellectual, policy, and political commitment to act multilaterally to turn the problems of an era into opportunities.

Some are calling for a 21^{st} Century approach, but many are falling back to mid-20^{th} Century models.

The New Multilateralism, suiting our times, will need to be a flexible network, not a fixed nor unitary system. It needs to maximize the strengths of interconnecting and overlapping actors and institutions, public and private.

We have seen that the more adaptable national economies handle the inevitable shocks and changes most effectively; applying that experience, the multilateral system needs to build in flexibility. It also needs to use markets and incentives for private sector organizations and individuals, profit-making and civil society NGOs.

The New Multilateralism should be respectful of state sovereignty, while at the same time recognizing that many issues do not respect state borders.

This New Multilateral Network needs to be pragmatic. Its baseline work is to foster cooperation by encouraging exchanges of perspectives on interests, both domestic and international. Often just sharing information is a start.

Then we should encourage a search for mutual interests. Sometimes mutual interests can be fostered with incentives – and international institutions can become catalysts for action. Practical problem-solving builds a culture of cooperation.

Our New Multilateralism must build toward a sense of shared responsibility for the health of the global political economy. This means – chiefly and critically – that it must involve those with a major stake in that economy, those willing to share in the responsibilities along with the benefits of maintaining it.

We must redefine economic multilateralism beyond the traditional focus on finance and trade. The changing world economy demands that we think more broadly. Today, energy, climate change, and stabilizing fragile and post-conflict states are economic issues. They are already part of the international security and environmental dialogue. They must be the concern of *economic* multilateralism as well.

V. Priorities

A New Steering Group

The New Multilateralism will still depend principally on national leadership and cooperation. Countries matter.

The G-7 is not working. We need a better group for a different time.

The G-20, though valuable, is too unwieldy in moving from discussion to action.

We need a core group of Finance Ministers who will assume responsibility for anticipating issues, sharing information and insights, exploring mutual interests, mobilizing efforts to solve problems, and at least managing differences.

For financial and economic cooperation, we should consider a new Steering Group including Brazil, China, India, Mexico, Russia, Saudi Arabia, South Africa, and the current G-7.

Such a Steering Group would bring together over 70 percent of the world's GDP, 56 percent of world population, 62 percent of its energy production, the major carbon emitters, the principal development donors, large regional actors, and the primary players in global capital, commodity, and exchange rate markets.

But this Steering Group would not be a G-14. We will not create a new world simply by remaking the old. It should be numberless, flexible, and over time, it could evolve. Others may be added, especially if their rising influence is matched by a willingness to help shoulder responsibilities.

This new Steering Group should meet and videoconference regularly to foster group responsibility. The Deputies should have frequent and informal discussions. An active network of bilateral consultations within and beyond the group will support it. We need a Facebook for multilateral economic diplomacy.

The IMF and World Bank Group, perhaps with the WTO, can help support this Steering Group. We can identify emerging problems, supply analysis, suggest solutions, and draw on our own broader membership to propose coalitions to address issues.

The Steering Group members will still need to work through established international institutions and regimes, which include other states. Sovereignties will be respected. But the core group would increase the likelihood that countries draw together to address problems that are larger than any one state.

We need this mechanism so that countries are not left to fail – with all the human, economic, and political consequences this entails for both them and their neighbors. We need it so that global problems are not just mopped up after the fact, but anticipated. We need it to develop the habit of dialogue and the necessary relationships of trust *before* the crisis hits. We need it to shape multilateral solutions.

<u>International Finance and Development</u>

We have seen the dark side of global connectedness. We need to navigate toward the light.

The first task will be close to home. Next year, there will be a major effort in the United States to overhaul the failed system of financial regulation and supervision. There will need to be improvements in clearing and settlement. Rules on transparency, capital, leverage, accounting, and increasingly important, liquidity, must be modernized.

We must ask why so many thoroughly regulated and supervised institutions got into trouble. Any risk-based model, no matter how sophisticated and well supervised, depends critically on the assumptions. What happens when the assumptions fail?

The changing conditions that trigger failure will increasingly be dependent on shifts in the *world* economy. Just as the crisis has been international because of interconnectedness, the reforms will need to be multilateral.

The Financial Stability Forum (FSF), ably chaired by Mario Draghi of the Bank of Italy, has started to tackle these issues. But the FSF concentrates on the OECD countries. Whether through an expanded FSF, a stronger FSF-IMF linkage, or the Steering Group, these financial supervisory issues will need to be addressed in a broader multilateral context.

We must bolster an IMF early warning system for the global economy, focused on crisis prevention and not just crisis resolution.

September's financial shock waves in the United States are reverberating in the global economy. The stark reality is that developing countries must prepare for a drop in trade, capital flows, remittances, and domestic investment, as well as slowdown in growth.

Countries with sound fiscal and balance of payments positions should be encouraged to spur domestic demand through consumption and investment. But others have little fiscal space, risky current account deficits, balance of payments problems, financial danger, or all four. The Fund and the Development Banks will need to assist. For some larger countries under threat, the

Steering Group and friendly countries should act in concert with the Fund and the Banks to offer support linked to policy reforms that will return the country to sustainable growth.

The IMF must also have an ongoing role in the world's exchange rates system, beyond surveillance. As Jean Pisani-Ferry wrote recently, a large part of the developing world is not yet ready for independent floating of their currencies, because of incomplete financial liberalization and anxieties about uncontrolled adjustment. The IMF, backed by the Steering Group, can offer more options, including pegs linked to currency baskets or commodities. Over time, we need to prepare for an international finance system with multiple reserve currencies, with others connected by various pegs.

The New Multilateralism must put global development on a par with international finance. Until we build a more inclusive globalization, the world will remain unstable, no matter how big the financial rescue packages.

Economic multipolarity offers stability and opportunity, just like a diversified portfolio of investments. But to boost more inclusive and sustainable growth, we need to think about aid differently.

Two weeks ago at the United Nations, international partners raised $16 billion for development projects. This money is vital, and we need more if we are to meet the Millennium Development Goals.

But we also must broaden our approach. We must listen to the growing number of Africans who are telling us they want markets and opportunities, not aid dependency. Private capital and markets will remain the drivers of growth. We must look beyond projects and programs to new ways of doing the business of development. We need innovative instruments and intermediation to: help connect Sovereign Wealth Funds to equity investments in Africa; build local currency bond markets in emerging markets; manage development risks through insurance facilities for weather and catastrophic events, and to help small farmers; demonstrate the viability of public-private financing partnerships to develop infrastructure; and broaden types of assistance, from advance commitments to develop life-saving pharmaceuticals to debt or rate buydowns.

While we build markets and institutions for the medium and longer term, the New Multilateralism needs mechanisms to move much more quickly and effectively to help those who are most vulnerable when crisis hits. One example is the World Bank's new $1.2 billion rapid financing facility for those endangered by high food prices.

Another example could be the reform of humanitarian food assistance. With a modest modernization of donor support to the World Food Program – such as core or multi-year funding and a credit line – we could apply financial market tools to help the WFP manage liquidity, market, and operational risks. Working with the World Meteorological Organization, the WFP and the Bank could better prepare, cut costs, and respond more quickly. We also need a worldwide agreement not to apply food export bans or prohibitive taxes to humanitarian purchases, as well as an agreement to release national reserve stocks should an excessive price increase occur due to hoarding or speculation. These risk management tools are the 21st Century equivalent to building big food stocks for security in eras past. But we need political leadership to break through old bureaucratic models.

The World Bank Group must also adapt more quickly to meet new needs of its clients and interests of its shareholders. We need to better align our governance with the realities of the 21st Century. To look beyond our initial steps for changing voice, representation, and responsibility, I will assemble a High Level Commission to consider the modernization of World Bank Group governance – so we can operate more dynamically, effectively, efficiently, and legitimately in a transformed global political economy. I am delighted that Ernesto Zedillo has agreed to lead this work. I have asked Ernesto to work with colleagues looking at governance issues at the IMF.

In 1944, at Bretton Woods, the Founding Fathers of economic multilateralism seized a moment to build a better future. We must be no less ambitious today.

The WTO and the Global Trading System

The Doha global trade negotiations in the WTO are gasping on life support. It is vital that the WTO and an open global trading system not be buried with them.

Trade negotiations will continue elsewhere. Recent research has shown how FTA negotiations can support broader opening of markets. But FTAs and preferential arrangements that are not broad-based could weaken global liberalization. They need to be linked to global disciplines. And the multilateral system remains the only option for lifting the heavy hand of trade-distorting support for agriculture, still running at some $260 billion per year.

Litigation in the WTO creates winners and losers. If not balanced with win-win negotiations, a WTO associated only with litigation will likely lose support. WTO members will need to consider how to continue to foster global liberalization.

One option is to shift trade facilitation from a negotiation to a development plan. There are opportunities to cut costs of trade far in excess of those imposed by tariffs and other trade barriers. The World Bank's "Doing Business" trading and "Logistics" indicators offer the diagnostic groundwork. Regional bodies such as APEC have pointed the way in practice.

We can help countries simplify and harmonize procedures and documentation across a supply chain. Countries can apply risk management techniques in border inspection and customs clearing, backed by electronic processing. And we can strengthen capacity, technology, and the availability of trade finance.

The original multilateral logic behind the GATT negotiations, which led to the WTO, was the "bargaining tariff." Even though it should be in a country's economic interest to lower tariffs and cut costs, political interests required "trading off" barriers that were defended by protected groups.

A new trade facilitation and development agenda puts the self-interest of lowering costs of trading to work for a multilateral interest of encouraging more integration, efficiencies, and opportunities –

meaning, more jobs, more growth, less poverty. As the exporters and importers do more business, they may be able to increase their voice for liberalizing negotiations, too.

This is multilateralism by practical steps, moving ahead where it is possible to do so.

Energy and Climate Change

The New Multilateral Network must also interconnect energy and climate change.
World energy markets are a mess. Producers, fearful of collapsing prices, are wary of new investments. Consuming countries want lower prices for consumers, but prices high enough to encourage conservation, efficiencies, alternative supplies, and new technologies. And the most vulnerable countries and people are victimized by the whole confusion – as they are hit by high prices, price volatility, and climate change.

Most oil production is now controlled by national oil companies. These suppliers do not respond to market signals in the same way as private producers.

We need a "global bargain" among major producers and consumers of energy. The International Energy Agency organized OECD consumers, but does not include all the rising powers. A few years ago, China suggested that the major energy consumers organize to deal more effectively with the producers' cartel. This is an idea worth considering, though with a broader purpose.

At a minimum, such a bargain should involve sharing plans for expanding supplies, including options other than oil and gas; improving efficiency and lessening demand; assisting with energy for the poor; and considering how these policies relate to carbon production and climate change policies.

Developed countries need to create and bring new technologies to market, to help both developed and developing countries. Developing countries need to reduce costly subsidies and increase efficiencies, while coping with social instabilities. And everyone should have an interest in preventing energy resources from triggering national security threats.

Part of the bargain will be to provide an opportunity for developing countries to make longer-term investments to reduce vulnerability to high and volatile fuel prices while supporting the poor with safety nets. Energy access needs to be a critical complement to clean energy investments. Over one and a half billion people in the world do not have access to electricity, including about three quarters of the population of sub-Saharan Africa. At the request of key shareholders, the World Bank Group is developing an Energy for the Poor initiative to help the poorest countries meet energy needs in efficient and sustainable ways.

We might consider taking the global bargain further. There could be a common interest in managing a price range that reconciles interests while transitioning toward lower carbon growth strategies, a broader portfolio of supplies, and greater international security.

Multilateral understandings about energy futures – leading to clear pricing for carbon – might also be vital for the UNFCCC negotiations on climate change. Countries are fearful that in a world of uncertain energy costs, technologies, and supplies, a climate change treaty will limit their growth or flexibility to adapt. A bargain among key producers and consumers might counter these risks, making it easier to commit to cut carbon.

A climate change accord also will have to be supported by new tools. We need new mechanisms to support forestation and avoid deforestation, develop new technologies and encourage their rapid diffusion, provide financial support to poorer countries, assist with adaptation, and strengthen carbon markets.

Two weeks ago, to help provide additional resources for these challenges, the Bank hosted a pledging session that raised $6.1 billion for new Climate Investment Funds.

The Steering Group should help push action on energy, the environment, and financing to assist the UN negotiations and the practical implementation of a treaty.

Fragile States: Securing Development

Nowhere is the New Multilateral Network needed more than in the fragile and post-conflict states where the "Bottom Billion" live.

Too often, the development community has treated states blighted by fragility and conflict simply as harder cases of development. Yet these situations require looking beyond the analytics of development to a different framework of building security, legitimacy, governance, and the economy. This is not security or development as usual. Nor is it about what we have come to think of as peace-building or peacekeeping.

Securing Development is about bringing security and development together first to smooth the transition from conflict to peace and then to embed stability so that development can take hold over a decade and beyond. Only by securing development can we put down roots deep enough to break the cycle of fragility and violence.

Our appreciation of how best to secure development – to synthesize security, governance, and economics to be most effective – is still modest. We face critical gaps in international capabilities.

Ultimately, the most important element in fragile or post-conflict states is the people of those countries. But it will take much stronger and longer-lasting multilateral assistance to help these people shift from being victims to becoming the principal agents of recovery. Beyond assistance, it requires new networked relationships between peacekeeping forces and development practitioners, and a new approach to security.

VI. Conclusion

Next month, the United States will elect a new President. That President will need to move beyond the firefight of financial stabilization. Dealing with the economic aftermath will be one of the foremost responsibilities of the next Administration.

That work is not about America alone. Both candidates have spoken about strengthening the sinews of America's ties with the world. How the next American President will do this matters.

Fate presents an opportunity wrapped in a necessity: To Modernize Multilateralism and Markets.